

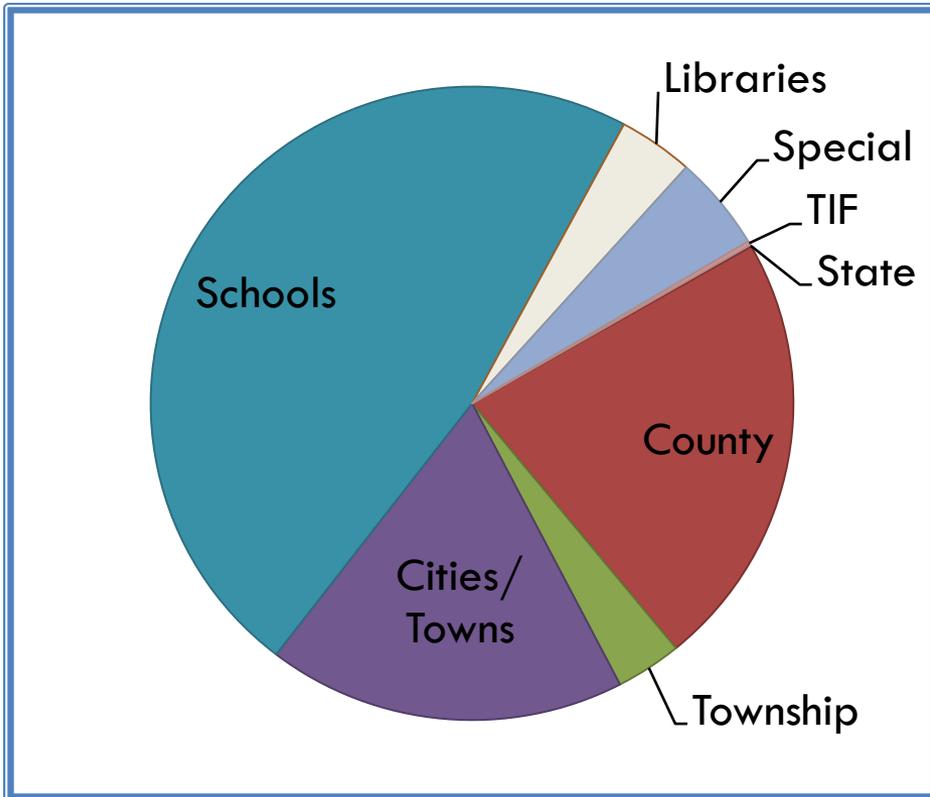
# Indiana Property Tax Revenues - The Challenges of Change

Prepared for the  
Commission on State Tax and Financing Policy

Legislative Services Agency  
August 27, 2007

# Property Tax By Unit Type

## 2007 Estimated Net Levy



Local Unit	Dollars (In Millions)	Percent
Schools	\$2,923.7	48%
Counties	1,375.8	22%
Cities/Towns	1,113.3	18%
Special	298.8	5%
Libraries	233.0	4%
Townships	205.0	3%
TIF Replacement	12.8	0%
State	5.5	0%
<b>Total</b>	<b>\$6,167.9</b>	<b>100%</b>

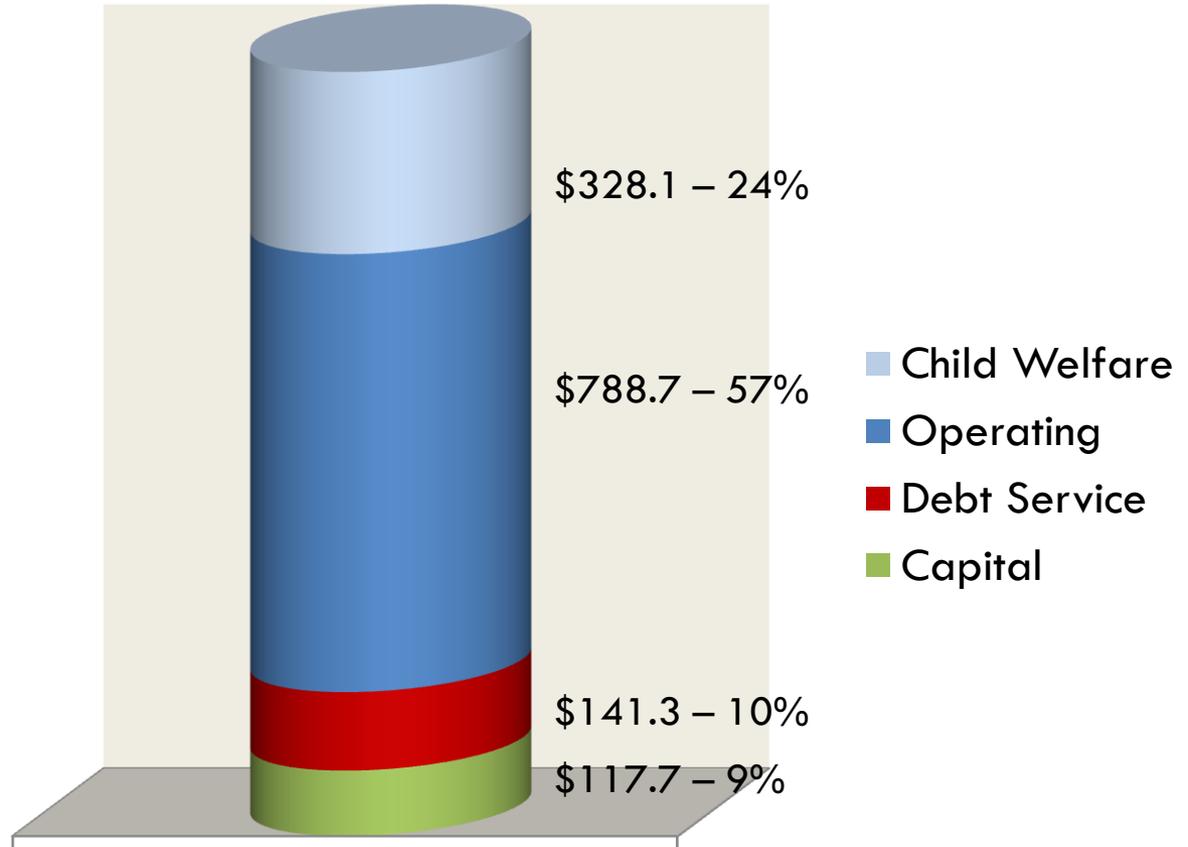
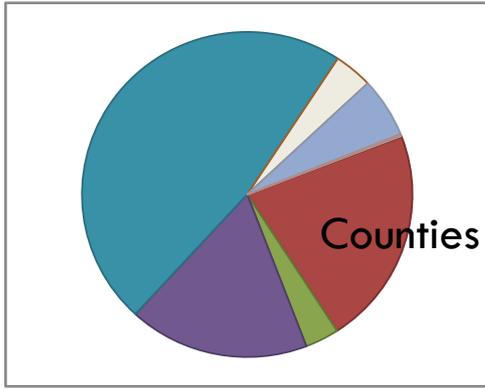
# Property Tax Uses - Total

3

Expense Category	2007 Estimated Net Levy (In Millions)	Percent
Operating	\$3,407.1	55%
Debt Service	1,458.5	24%
Capital	968.7	16%
Child Welfare	328.1	5%
State	<u>5.5</u>	<u>0%</u>
<b>Total</b>	<b>\$6,167 .9</b>	<b>100%</b>

# Property Tax Uses - Counties

4

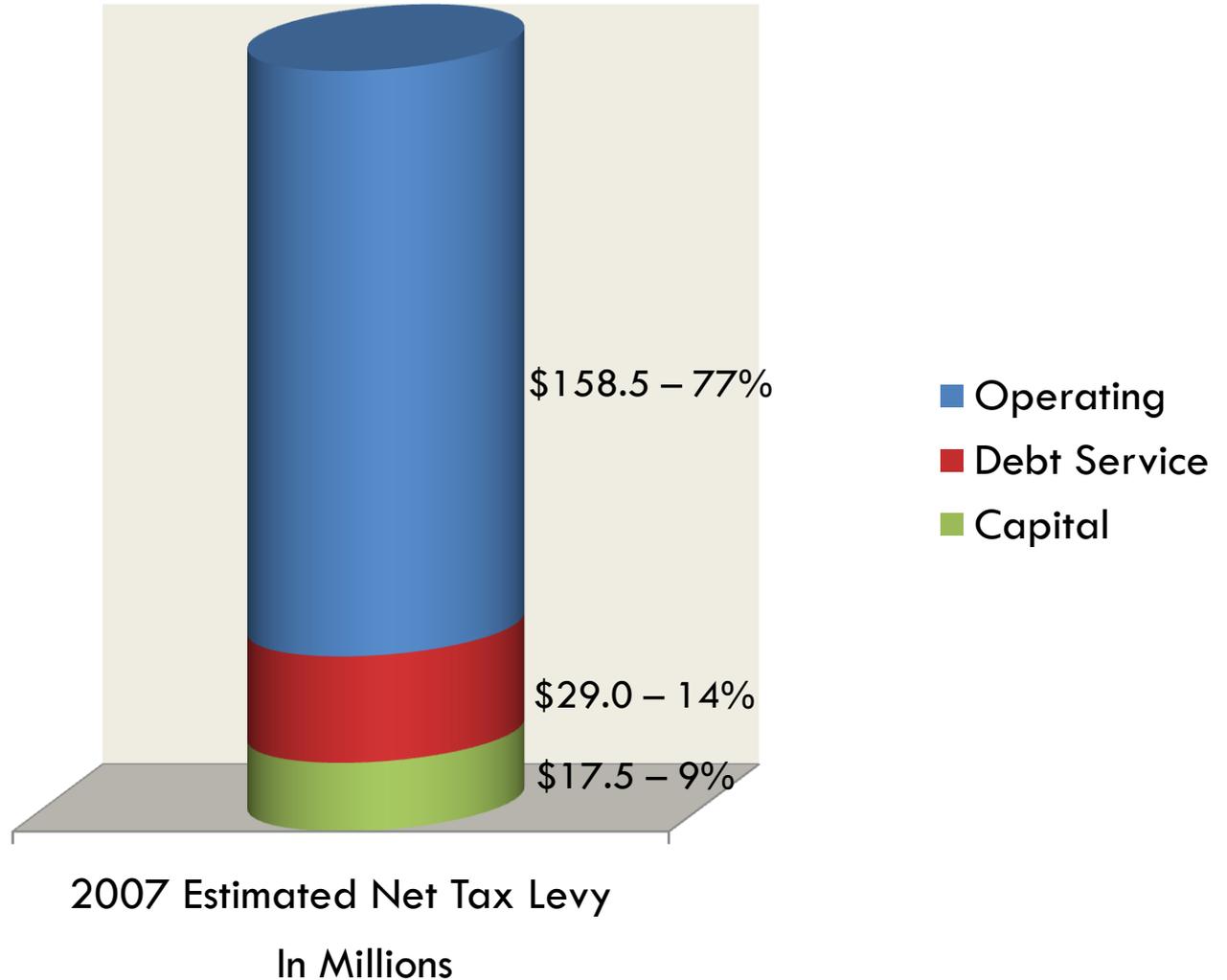
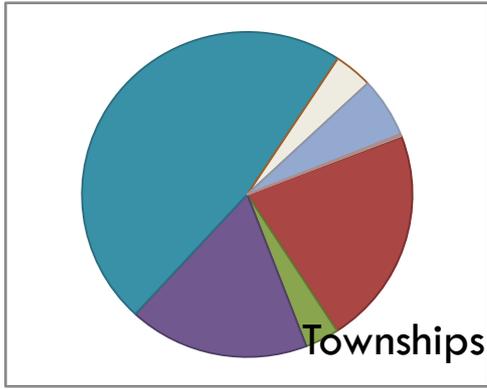


2007 Estimated Net Tax Levy

In Millions

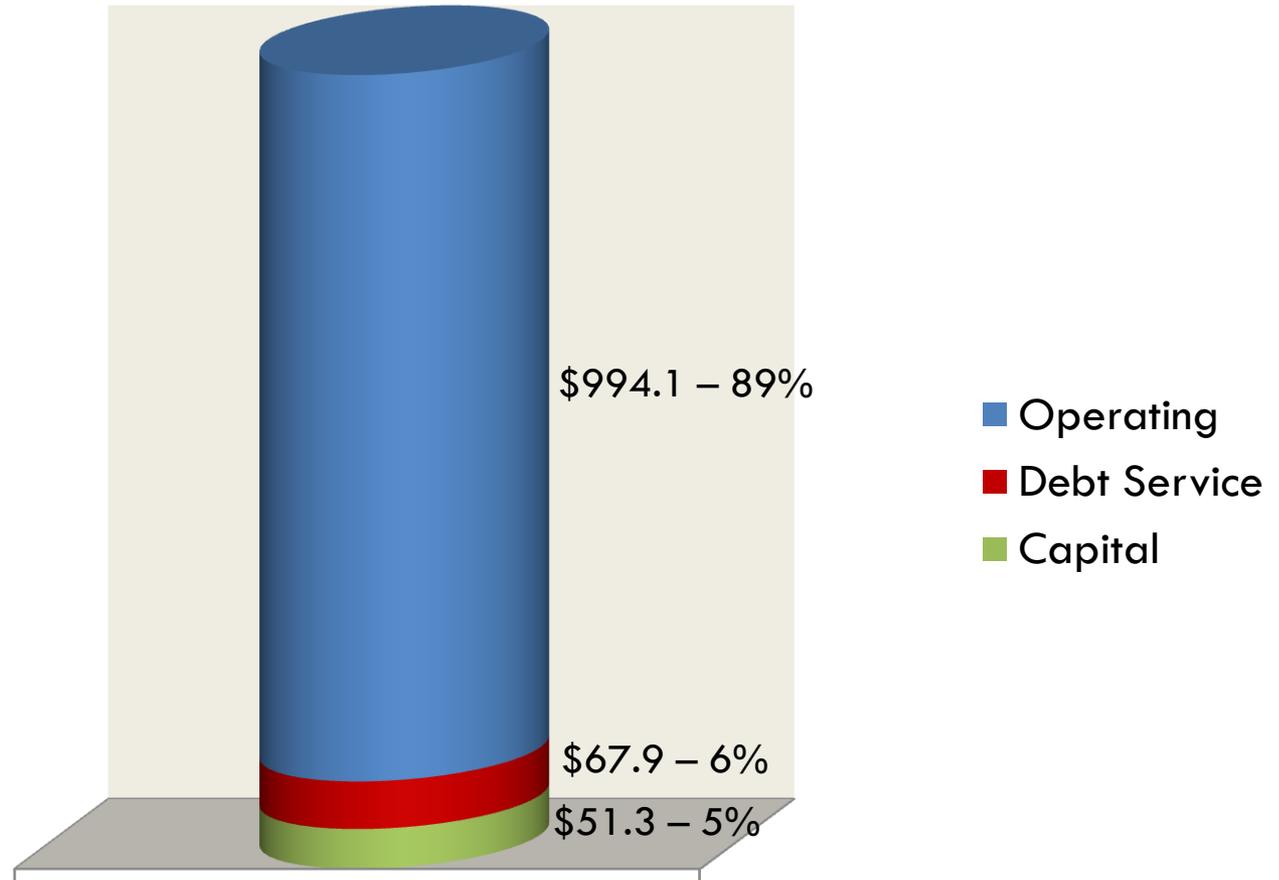
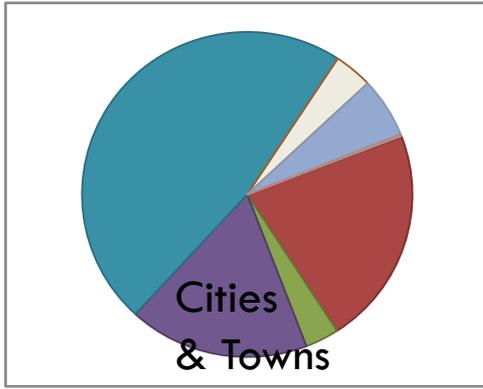
# Property Tax Uses - Townships

5



# Property Tax Uses – Cities and Towns

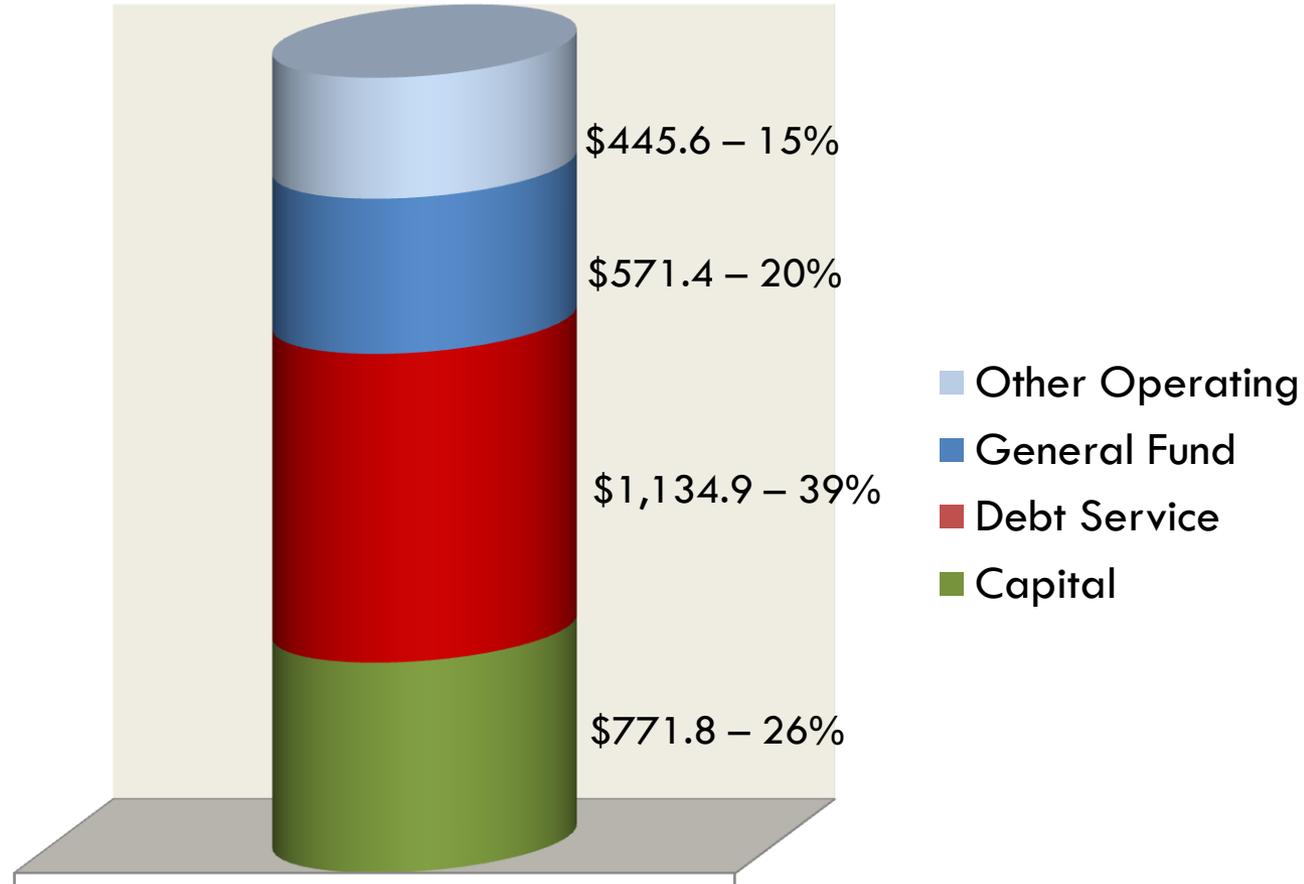
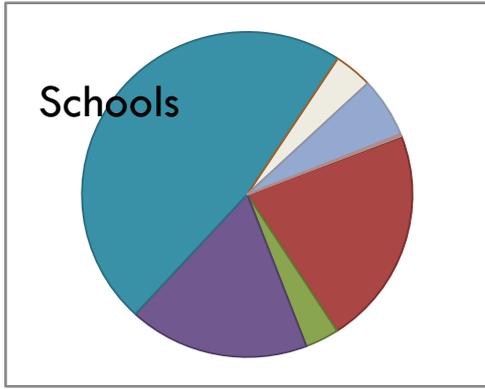
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2007 Estimated Net Tax Levy  
In Millions

# Property Tax Uses – Schools

7



2007 Estimated Net Tax Levy  
In Millions

# State Tax Revenue by Source

8

**FY 2007**

\$5,423.5

- Sales Tax

\$4,580.4

- Individual Adjusted Gross Income Tax

\$746.4

- Corporate Adjusted Gross Income Tax

\$209.7

- Utility Receipts Tax

\$187.1

- Insurance Premiums Tax

\$76.4

- Financial Institutions Tax

# Current Sales Tax Exemptions

9

40+ exempt retail sales transactions

Wholesales sales

Double Direct – sales of goods directly used in direct production in manufacturing, farming, & public utilities

Food

# Sales Tax on Services

10



Expansion of existing tax base



Transition from goods to service economy



49 states tax services



Number of services taxed range from  
1 to 168

# Property Tax Replacement Calculator

Prepared by Senator David Ford and Available on His Senate Website

<u>Replacement of Property Tax Calculation (Million \$)</u>						
<u>Tax Type</u>	<u>2006 Revenue*</u>	<u>Current Rate</u>	<u>Proposed Increase</u>	<u>Rate after Increase</u>	<u>Approximate Revenue Increase</u>	<u>Increased \$ Amount Per 1%</u>
Sales Tax	5,269.8	6%	<input type="text" value="0.0%"/>	6.0%	-	878.3
Individual Income Tax	4,322.2	3.4%	<input type="text" value="0.0%"/>	3.4%	-	1,271.2
Corporate Adj.Gross Income	703.2	8.5%	<input type="text" value="0.0%"/>	8.5%	-	82.7
Financial Institutions Tax	61.7	8.5%	<input type="text" value="0.0%"/>	8.5%	-	7.3
Insurance Tax	177.7	1.3%	<input type="text" value="0.0%"/>	1.3%	-	136.7
Utility Receipts	144.0	1.4%	<input type="text" value="0.0%"/>	1.4%	-	102.9
<b>TOTAL</b>					-	
<u>Property Tax (Pay 2006)</u>	<u>Gross Levy</u>	<u>PTRC</u>	<u>Net Levy</u>	<u>Homestead Credit</u>	<u>Final Net Levy</u>	
	7,821.1	1,804.3	6,016.8	362.5	5,654.3	
Difference still needed to replace property tax dollar for dollar					<b>\$ 5,654.3 million</b>	

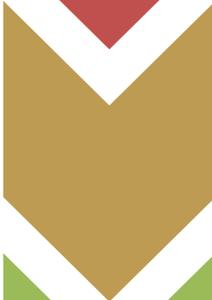
\* Does not include income from one-time amnesty program.

# Issues Related to Expanding Tax Bases

12



- Surrounding States Rates



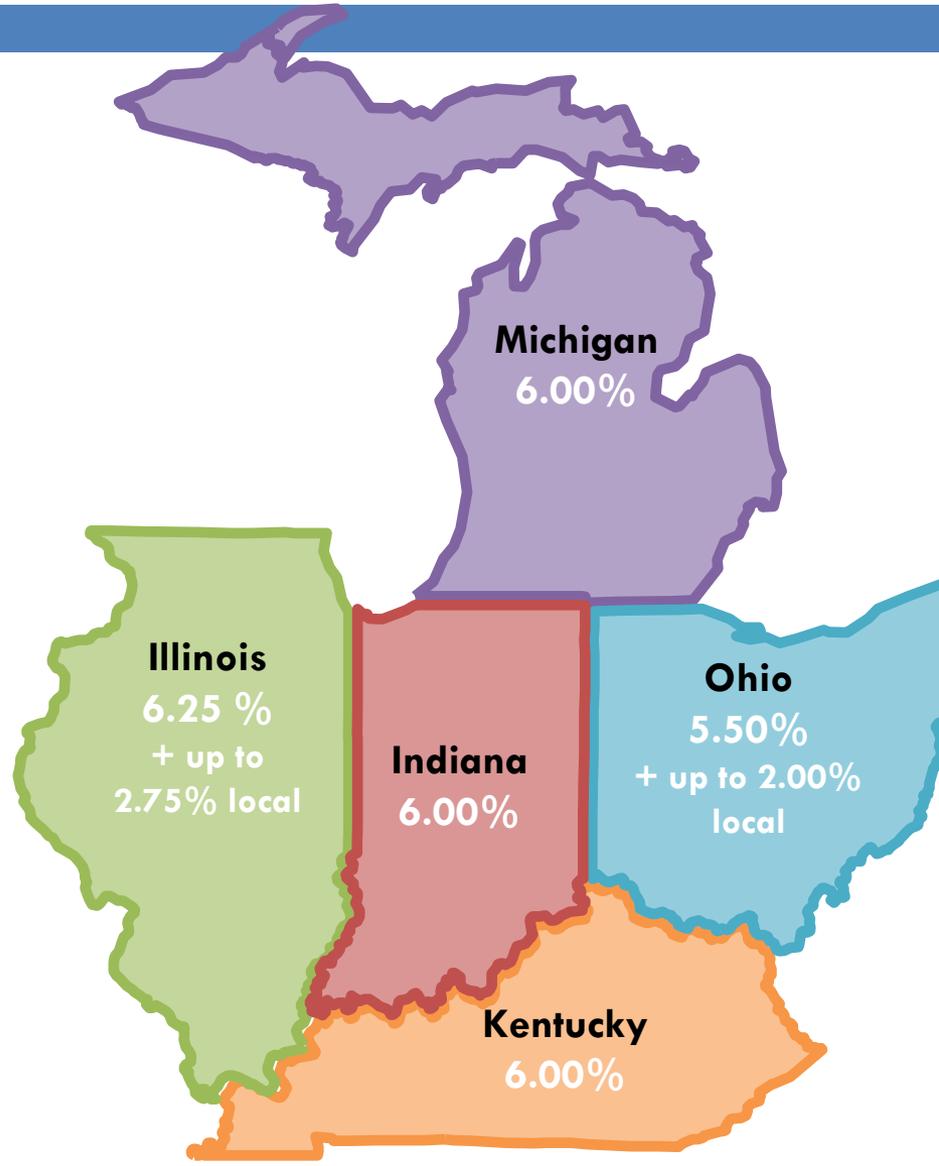
- Elasticity of Tax Base



- Interactive Effect of Multiple Tax Policy Changes

# Sales Tax Rates

13



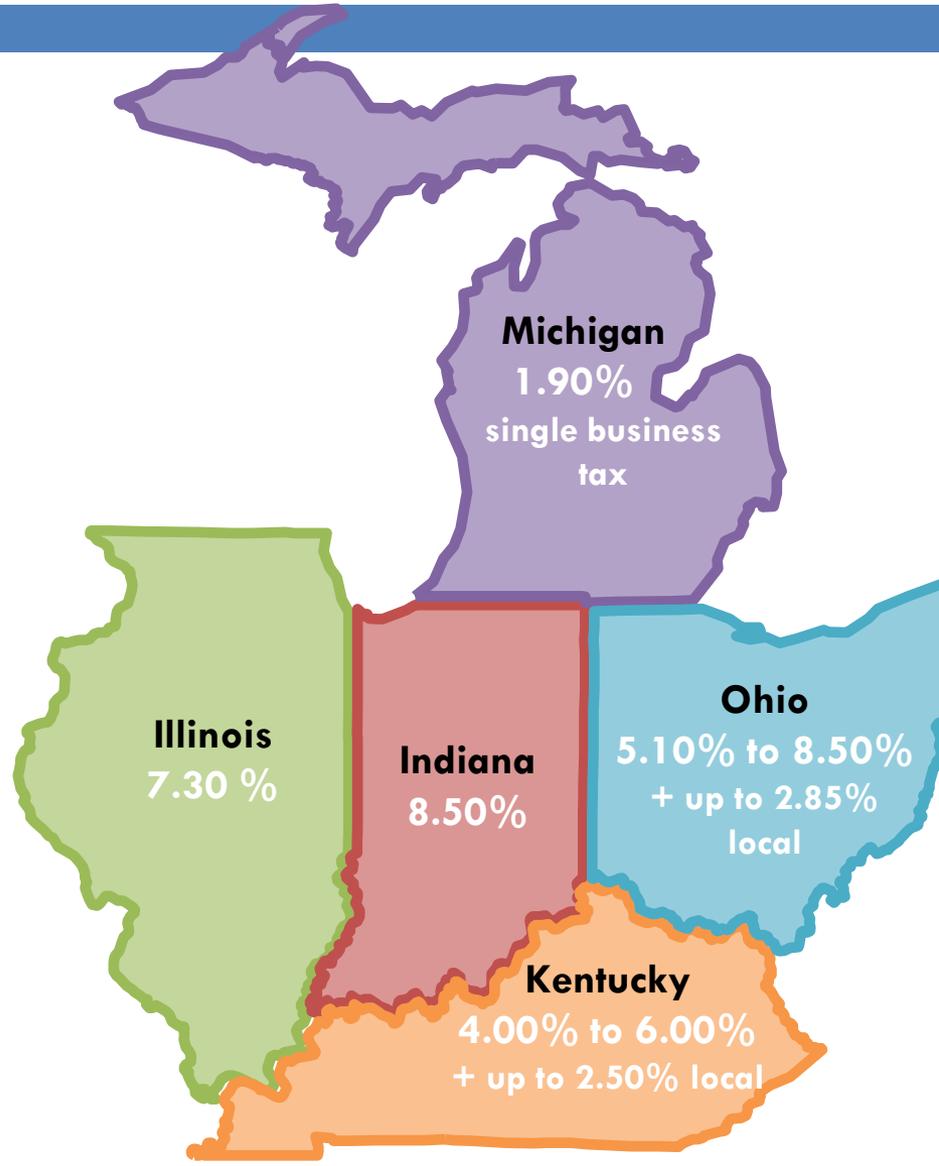
# Individual Income Tax Rates

14



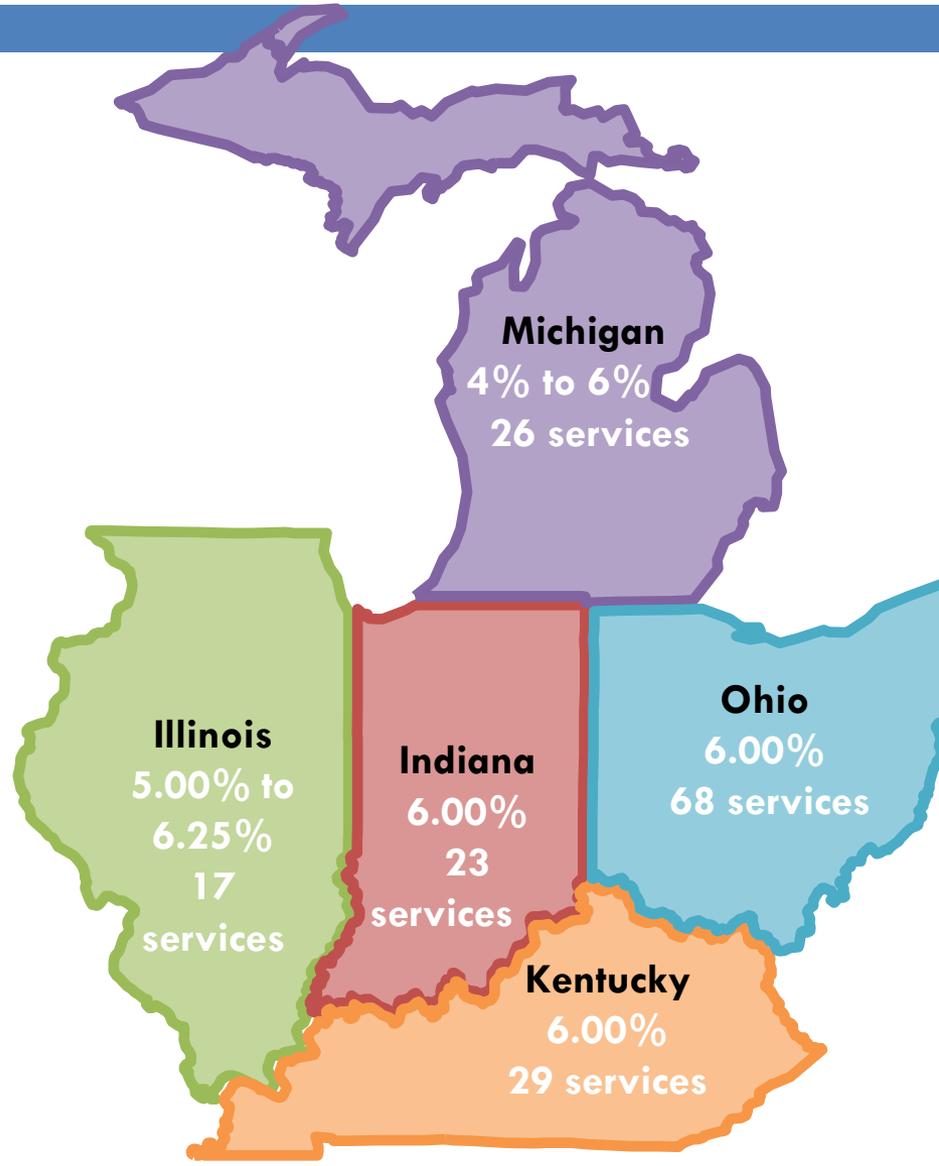
# Corporate Income Tax Rates

15



# Sales Tax on Services

16



# Implications of Tax Rate Comparisons

17

- Suggests only some responses rate increases.
  - ▣ Tax competitiveness issues.
  - ▣ Border area effects.
- Neglects other potential responses to rate increases.
  - ▣ Reductions in taxable consumption for various reasons.
  - ▣ Steering income to tax exempt or tax deferred activities.
  - ▣ Work versus leisure.
  - ▣ Shift in business organization – C-Corporations versus pass-through status.

# Elasticity Concept

18

- Quantifies the responsiveness of economic measures to other economic or policy changes.
  - % change in one economic measure for a given % change in another economic measure.
- Utilized to measure the response of a tax base to changes in statutory tax rates.
- Example: Tax rate elasticity of the sales tax base.
  - % change in taxable retail sales for a given % change in the sales tax rate.
  - Measures the behavioral response by consumers due to the increase in the after-tax price of goods.

# Elasticity Concept - Example

19

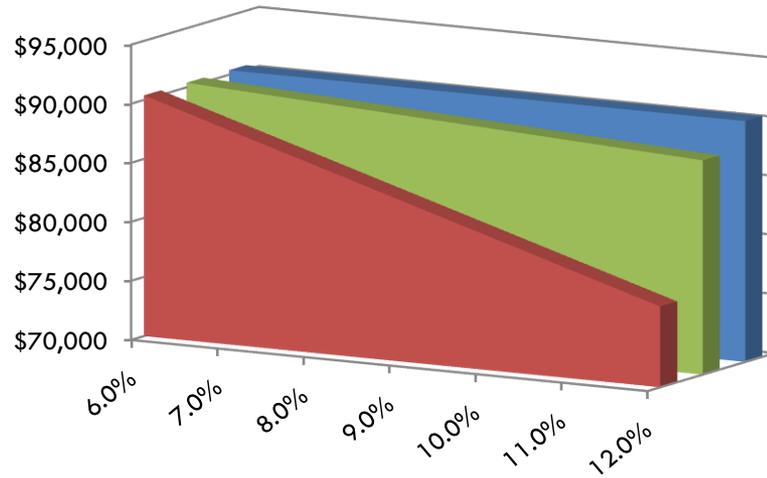
-- What is the potential yield from raising the sales tax rate from 6% to 7%? --

- If a behavioral response does not occur:
  - ▣ Revenue increases in proportion to the rate increase of 16.7%.
- If a behavioral response does occur:
  - ▣ Revenue increases by less than 16.7% as the sales tax base shrinks.
    - Consumer budget constraints
    - Necessities vs. luxuries
    - Leakage – border effect, catalog sales, internet sales

# Elasticity of Sales Tax

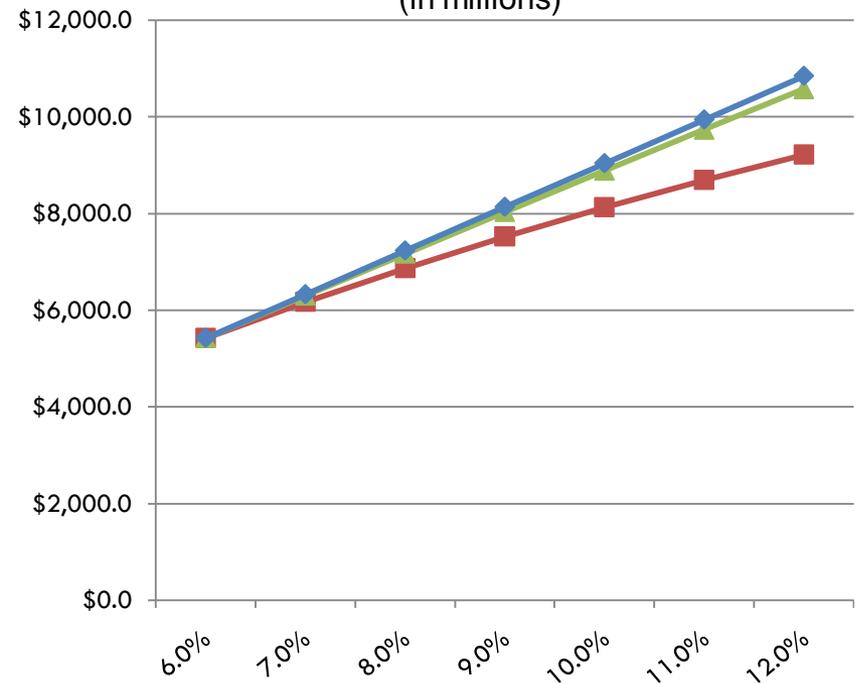
20

## □ Sales Tax Base Response (in millions)



- HIGH Responsive Sales Tax Base
- LOW Responsive Sales Tax Base
- Unresponsive Sales Tax Base

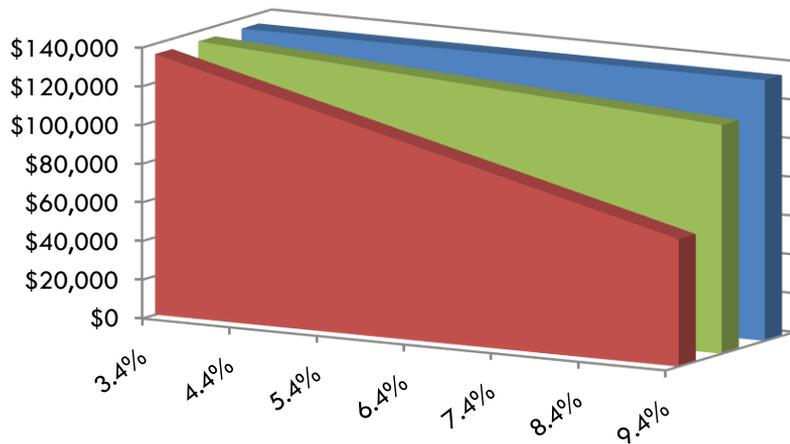
## □ Sales Tax Revenue Response (in millions)



- Yield from HIGH Responsive Sales Tax Base
- ▲ Yield from LOW Responsive Sales Tax Base
- ◆ Yield from Unresponsive Sales Tax Base

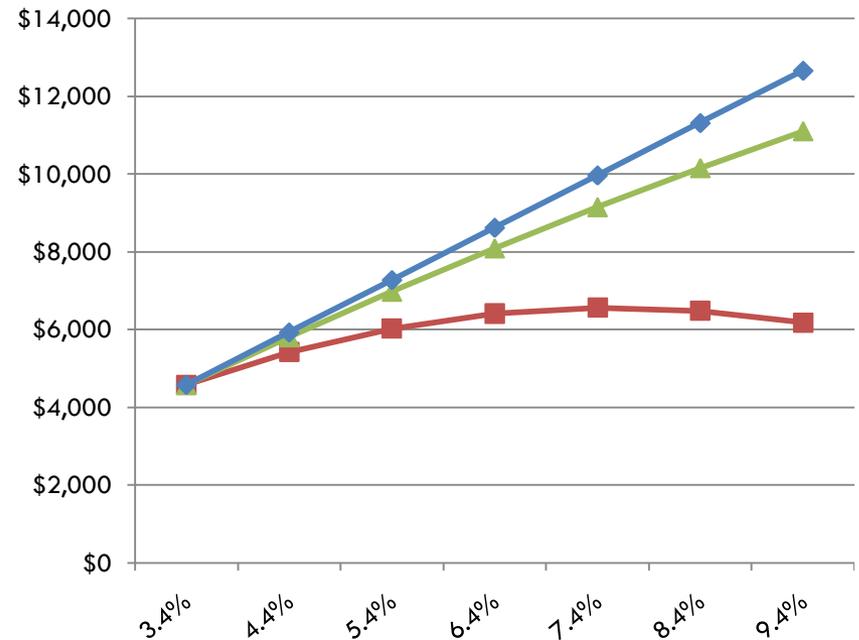
# Elasticity of Individual Income Tax

Income Tax Base Response  
(in millions)



- HIGH Responsive Individual AGI
- LOW Responsive Individual AGI
- Unresponsive Individual AGI

Income Tax Revenue Response  
(in millions)

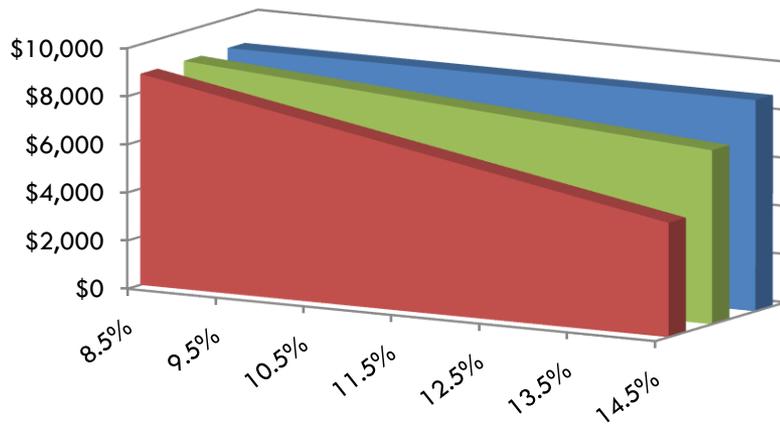


- Yield from HIGH Responsive Individual AGI
- ▲ Yield from LOW Responsive Individual AGI
- ◆ Yield from Unresponsive Individual AGI

# Elasticity of Corporate Income Tax

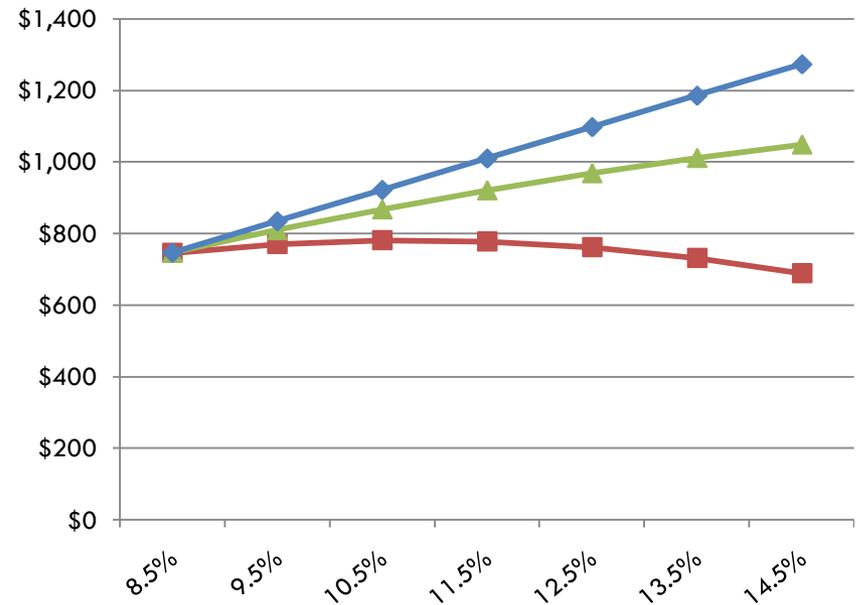
22

## Corporate Tax Base Response (in millions)



- HIGH Responsive Corporate AGI
- LOW Responsive Corporate AGI
- Unresponsive Corporate AGI

## Corporate Tax Revenue Response (in millions)



- Yield from HIGH Responsive Corporate AGI
- Yield from LOW Responsive Corporate AGI
- Yield from Unresponsive Corporate AGI

# Interactive Effects

23

- Tax base elasticity estimates.
  - ▣ Are estimates of the aggregate response to tax rate increases.
  - ▣ Assume all other policies are unchanged.
- What happens if property taxes are replaced?
  - ▣ The aggregate tax base response could change when combined with property tax reductions.
  - ▣ Individual responses will vary depending on individual differences in income, consumption patterns, and property tax burdens.

# Revenue Given Tax Base Response

Sales Tax			
Tax Rate	% Increase	HIGH Responsive Tax Base	LOW Responsive Tax Base
6.0%			
7.0%	16.7%	\$745.7	\$877.6
8.0%	33.3%	\$1,446.3	\$1,747.6
9.0%	50.0%	\$2,101.6	\$2,610.1

Individual Income Tax			
Tax Rate	% Increase	HIGH Responsive Tax Base	LOW Responsive Tax Base
3.4%			
4.4%	29.4%	\$841.6	\$1,225.1
5.4%	58.8%	\$1,453.4	\$2,394.8
6.4%	88.2%	\$1,835.3	\$3,509.0

Corporate Income Tax			
Tax Rate	% Increase	HIGH Responsive Tax Base	LOW Responsive Tax Base
8.5%			
9.5%	11.8%	\$24.0	\$63.3
10.5%	23.5%	\$34.6	\$121.4
11.5%	35.3%	\$31.8	\$174.3

# Sales Tax on Services

25

**Estimated increase in sales tax revenue for each 1% increase in tax rate.**

<b>Sales Tax Rate on Services</b>	<b>Additional Sales Tax Revenue</b>
1%	\$176.6
2%	349.1
3%	517.7
4%	682.2
5%	842.8
6%	999.3

# Property Tax Replacement Options

26

## Three Revenue Scenarios for FY 2007

- Individual Adjusted Gross Income Tax
- Sales Tax (no services)
- Sales Tax (with services)

# Individual Income Tax Rate

27

## Scenario for FY 2007

Current Individual Adjusted Gross  
Income Tax Rate: 3.4%

### Replace 50% of Levy

New Total Tax Rate: 6.0%

Additional Rate: 2.6%

Additional Revenue: \$3,070

### Replace 100% of Levy

New Total Tax Rate: 9.0%

Additional Rate: 5.6%

Additional Revenue: \$6,146

CY 2007 Estimated Net Property Tax Levy = \$6,168

# Sales Tax Rate Increase

28

## Scenario for FY 2007

Current Sales Tax Rate: 6.0%

Replace 50% of Levy

New Total Tax Rate: 9.5%

Additional Rate: 3.5%

Additional Revenue: \$3,039

Replace 100% of Levy

New Total Tax Rate: 13.2%

Additional Rate: 7.2%

Additional Revenue: \$6,150

CY 2007 Estimated Net Property Tax Levy = \$6,168

# Expansion of Sales Tax to Services

29

## Scenario for FY 2007

Current Sales Tax Rate on Services:  
N/A

### Replace 50% of Levy

New Total Tax Rate: 8.0%

Additional Rate: 2.0%

Add'l Nonservice Revenue:  
\$1,748

Add'l Service Revenue: \$1,300

### Replace 100% of Levy

New Total Tax Rate: 11.1%

Additional Rate: 5.1%

Add'l Nonservice Revenue:  
\$4,397

Add'l Service Revenue: \$1,736

CY 2007 Estimated Net Property Tax Levy = \$6,168

# Other Fiscal and Legal Matters

30



Administrative Cost of  
the Assessment System



Bonds Supported by  
Property Tax Revenue



Legal Issues

# State and Local Administrative Expenses

31

- 
- \$73.5 M Avg. Local Costs (2001-2005)

- 
- \$4.4 M Avg. State Costs

- 
- 1.5% of Net Property Tax Collections

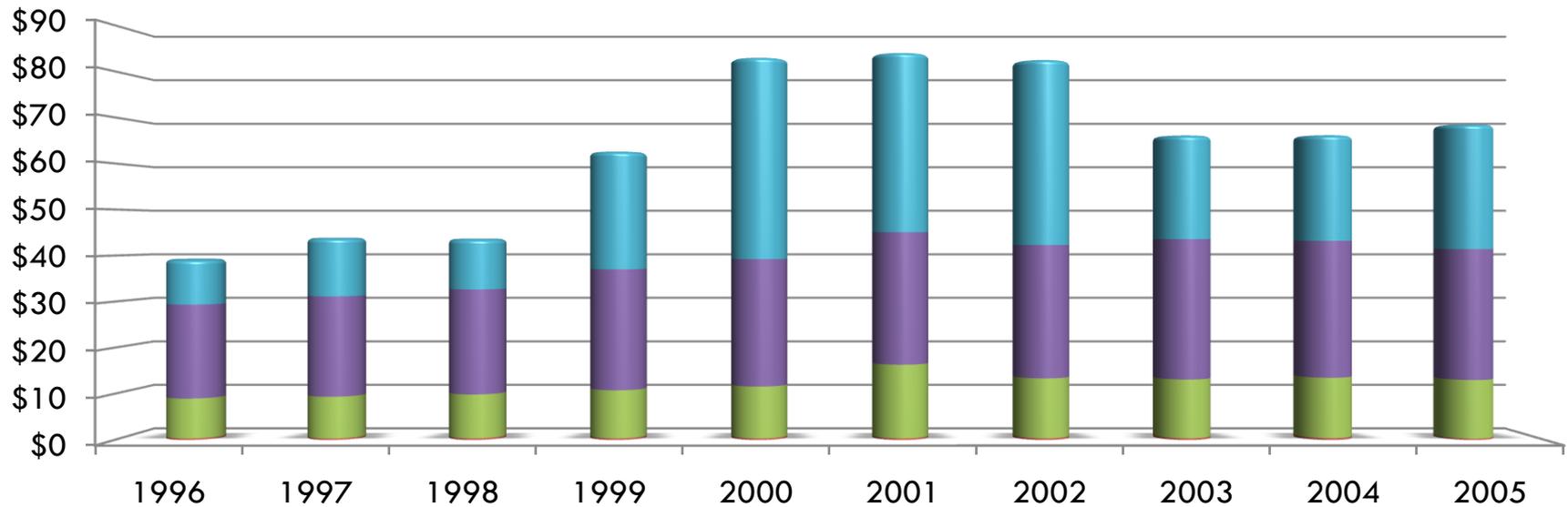
# Local Administrative Expenses

32

## Assessment System Appropriations

(includes additional appropriations)

In Millions



- Reassessment Fund
- Township Assessor
- County Assessor
- Board of Review
- Tax Adjustment Board

# Bonds Supported by Property Taxes

33

**Based on 2005 Local Unit Self-Report to  
the Department of Local Government Finance.**



86 counties reporting



\$3.1 billion in principle  
outstanding



Range of interest rate between  
2% and 8%

# Other Fiscal and Legal Issues

34



Contract with bond holders



Collection of special assessments



Effective federal income tax rate



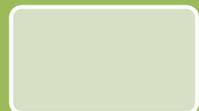
Impact on borrowing costs



Calculation of debt



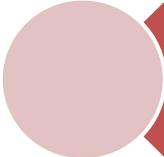
Calculation of revenue



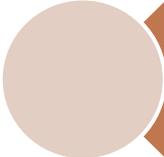
Transition Issues

# Summary

35



2007 Estimated Net Property Tax Levy



Major Sources of State Revenue



Issues Impacting Expansion of Tax Bases



Scenarios to Replace Part or All of  
Property Taxes



Other Fiscal and Legal Issues